DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/84/196
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

August 21, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Mauritius - Staff Report for the 1984 Article IV Consultation

The following corrections have been made in SM/84/196 (8/14/84):

Page 10, 1st full para., line 9: delete "banks are scheduled to decline substantially and"

Page 17, 3rd full para., after line 9 add: "considerable excess liquidity. This situation has reduced the incentive"

last line: for "considerable excess liquidity. This situation has reduced the" read "on banks to lower rates on credit to priority sectors. The"

Page 19: delete first line

Page 21, Table 7: replace with attached table

Corrected pages are attached.

Att: (4)

Other Distribution:
Department Heads

This reflected large increases in disbursements of concessionary loans, including SDR 19 million under SAL II. On the other hand, there was a sizable net outflow of private capital (including errors and omissions), as the sugar syndicate repaid short-term loans of SDR 13 million borrowed in 1982/83. The overall balance is estimated to have registered a deficit of SDR 36 million, financed by net purchases from the Fund (SDR 13 million) and a rundown of reserves (SDR 23 million), to the equivalent of one week's imports. 1/

In 1984/85 the sugar crop is likely to be even lower than in 1983/84 owing mainly to drought, and the value of sugar exports is likely to decrease by almost 5 percent. This reduction will be more than offset by a strong rise (15 percent) in EPZ exports, resulting in about 1 percent increase in total exports. Imports, however, should increase by about 5 percent, due primarily to higher EPZ imports of inputs and capital equipment. The public sector capital account should improve again by a large amount, as amortization payments due to commercial banks are scheduled to decline substantially and disbursements on concessionary loans already contracted should continue to increase with the second tranche of the SAL II and a new structural adjustment loan from the African Development Bank. As a result, a sharp reduction in the overall deficit to SDR 8 million is projected. However, given net repurchases to the Fund (after the final purchase effected in July 1984 under the 1983/84 stand-by arrangement), an unfinanced gap of SDR 44 million is projected. 2/

The Mauritian representatives recognized that both additional financing and continuation of the adjustment path would be required. In March 1984 the authorities approached the Eurocurrency market for a fifth loan to fill a part of the gap. They also intend to request a fifth stand-by arrangement with the Fund and a possible purchase under the compensatory financing facility. They stated that further commercial borrowing could be justified in light of the adjustment that has occurred and the bunching of debt service payments. On the basis of currently contracted debt, and the assumption of the maintenance of the 1984/85 nominal level of gross concessionary capital flows, total debt service payments (including charges and repurchases to the Fund) are expected to peak in 1984/85 (27 percent of exports of goods and nonfactor services) and to decline thereafter (Tables 4 and 7). By financing part of the gap in 1984/85, the authorities felt they would be able to smooth debt service payments and prevent a too extreme short-term adjustment from compromising their medium-term goals. The authorities recognize that, parallel with the financing, continuation of adjustment would be required in order to avoid in the future a situation in which the debt service would be unsustainable. The mission

---

1/ Net of a buildup of short-term reserve liabilities in the form of commercial bank deposits in foreign exchange at the Bank of Mauritius.

2/ The gap would rise to SDR 47.6 million if Mauritius were required to repurchase the outstanding amount under the buffer stock facility.

excessive distribution of dividends and discouraged capital formation. Therefore, in the 1984/85 budget, the deduction for dividend distribution was eliminated, and the tax rate was reduced to 35 percent for both public and private companies; this change is considered to be revenue neutral.

The structure of import taxes and the administration of the customs department are currently being studied, with the principal objectives of rationalizing the tariff and increasing revenue. Concurrently, in conformity with the IBRD SAL II, studies are under way to determine the level of tariffs that should provide protection for domestic industries to replace the quota restrictions on imports. In addition, UNIDO has sponsored a study on industrial policy to consider the effect of the tariff structure on local manufacturing and the possibility of providing rebates on duties to firms outside the EPZ scheme. Coordination of the various recommendations will be carried out by the Ministry of Finance.

4. Money and credit

During 1983/84 domestic credit and money supply grew at a slower pace than in the preceding year. Total domestic credit rose by 16 percent; net credit to the Government, increased by 15 percent while credit to the private sector rose by 18 percent (Table 6). 1/ Compared with 1982/83, there was an acceleration in the increase in private credit and a deceleration in the increase in net credit to the Government. The rate of monetary growth greatly fell to 8 percent in 1983/84 from 21 percent in 1982/83.

The Bank of Mauritius controls the volume of private sector credit by establishing a quarterly ceiling on credit expansion for each bank. The ceilings are determined by a formula that takes into account for each bank the increase in its lending to the priority sectors 2/ and its performance in mobilizing time and savings deposits, with a greater weight on the latter. Given the tight controls on credit expansion in recent years, and the progressive liberalization of interest rates in 1983, deposits, particularly time deposits, have grown by more than credit expansion, and the banking system as a whole has accumulated considerable excess liquidity. This situation has reduced the incentive for most banks to expand their deposit base further. The excess liquidity also resulted in a downward pressure on deposit rates in the first half of 1984, which has been reinforced by pressures from the authorities on banks to lower rates on credit to priority sectors. The

---

1/ On a performance criteria basis (i.e., including drawings by Government on Eurocurrency loans), total domestic credit increased in 1983/84 by 13 percent and net credit to the Government by 10 percent, compared with 16 percent and 20 percent, respectively, in 1982/83.

2/ Agriculture, EPZ, and Development Certificate companies.

pressures reflected the authorities' concern regarding the widening of the spread between average lending and deposit rates since the start of the liberalization process. The Mauritian representatives stated that, despite the reduction in deposit rates, these have remained substantially positive in real terms. In regard to interest rates on credit, they said that there was a need to influence their level in general and between sectors in particular. This is in keeping with the objective of restricting the imports of consumer goods and encouraging investment and employment in export sectors.

The authorities, conscious of the rigidities of the current system of credit control, are considering a system of indirect credit controls, utilizing cash and liquidity ratios to keep credit expansion to the desired level. Parallel with the increase in investment in the EPZ, there has been an increase in demand for credit. The authorities are concerned that tight credit policies might have a negative effect on investment activity as the Government and the sugar industry absorb a large share of available resources, raising the possibility that credit to EPZ, where investment opportunites exist, might be crowded out. 1/

5. The exchange and trade system

Mauritius has a relatively liberal system of trade and payments. Imports subject to quantitative restrictions represented in 1981 (the year during which most of the restrictions were imposed) about 11 percent of the total value of imports. An important element of the 1983/84 program was the progressive reduction in these restrictions with the objective of an eventual complete liberalization of the system. At the time the program was formulated, there were three lists of restricted imports: (a) those that were completely prohibited to protect local industry; (b) those that were restricted by quota, also for the protection of the local industry; and (c) those restricted by quota for balance of payments reasons. In March 1984 all prohibited items under list (a) were made subject to quotas equivalent to 25 percent of the domestic market demand. However, import licenses are granted only to traders who can prove that they had imported these items before the ban was imposed. Thus far, no license has been granted. The Government hopes that all quotas under lists (a) and (b) will be removed by end-1984 and replaced by appropriate tariffs that will be progressively reduced. In regard to goods on list (c), those that are subject to tariffs of 30 percent or more have already been completely liberalized. The Mauritian representatives stated that so far about 70 percent of previously restricted imports had been liberalized. They added that goods subject to tariffs of less than 30 percent would be liberalized by end-1984.

1/ Commercial bank credit to the EPZ increased by 14 percent in the first quarter of 1984, after declining in real terms during 1982 and 1983.

Table 7. Mauritius: Medium-Term Balance of Payments and External Debt Outlook, 1983/84-1989/90

(In millions of SDRs)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Exports, f.o.b.	345	349	382	403	426	452	478
Imports, f.o.b.	-365	-384	-410	-443	-473	-508	-544
Trade balance	-20	-35	-28	-40	-47	-56	-66
Invisibles (net)	-7	-8	-7	--	7	12	22
Of which: investment income 1/	(-37)	(-44)	(-44)	(-42)	(-42)	(-43)	(-44)
Current account	-27	-43	-35	-40	-40	-44	-44
Capital (net) 1/	-9	35	37	41	35	32	32
Overall balance	-36	-8	2	1	-5	-12	-12
IMF (net)	13	-36	-44	-28	-23	-15	-13
Purchases	(33)	(8) 2/	(--)	(--)	(--)	(--)	(--)
Repurchases	(-20)	(-44)	(-44)	(-28)	(-23)	(-15)	(-13)
Reserves	23	...	...	...	...	...	...
Financing gap	--	44	42	27	28	27	25
Debt service							
1. On existing debt and assumed inflow of concessionary capital	117	131	128	106	108	105	104
2. On additional debt for financing the gap 3/	--	3	9	28	49	71	100
3. Total debt service (1+2)	117	135	137	134	157	176	204
Debt service ratio	24.6	27.8	25.8	23.7	26.0	28.7	29.7
of which: on existing debt and assumed inflow of concessionary capital	(24.6)	(27.0)	(24.1)	(18.8)	(17.9)	(17.1)	(15.1)

Source: Staff projections prepared jointly with the Mauritian authorities.

1/ On the basis of currently contracted debt, and assuming constant inflow of concessionary capital at the level projected for 1984/85. Investment income does not include interest on additional debt for financing the gap.
2/ The final purchase effected under the 1983/84 stand-by arrangement.
3/ Assuming that the gap is financed entirely on commercial terms.